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SUBJECT: MERKEL,S STIMULUS BY STEALTH

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11. (SBU) SUMMARY. Chancellor Merkel's April 22 "Economic Summit" yielded remarkably little in the way of breakthroughs or announcements. The gathering did, however, help clarify Germany's economic outlook and enable the Chancellor to claim broad support for her economic stewardship, including her refusal to propose a third stimulus. High-level participants from government, industry, and trade unions as well as economists agreed that the German economy probably bottomed out in the first quarter of 2009, and that the slump would continue into 2010. A whiff of spring was also in the air, as some participants saw an end to the recession on the distant horizon. The employment picture, however, is increasingly gloomy. This factor more than any other might compel the Chancellor, whether she likes it or not, to promise additional stimulus measures as she heads into the September elections. Merkel is, in fact, already taking smaller steps not requiring legislative approval that are meant to have a stimulatory effect, and is preparing the ground for tax cuts after the elections. END SUMMARY.

MERKEL'S APRIL 22 "ECONOMIC SUMMIT"

12. (U) Chancellor Angela Merkel's April 22, 2009 "Economic Summit," which brought together high-ranking representatives from the German government, industry, academia, and labor unions to discuss the state of the German economy, produced no major announcements. The stated rationale for the meeting was to "inform" the government before the April 29 release of its revised 2009 growth forecast. While a similar meeting on December 14, 2008 was held amidst the buzz of a possible second stimulus package, Merkel was very clear that discussion of a third such package was not even on the agenda this time. Following the meeting, Finance Minister Peer Steinbrueck told reporters the German economy could shrink by 5 percent this year, but that a plan in the works to help banks deal with troubled assets could hasten the end of the downturn. Economics Minister Karl-Theodor zu Guttenberg added that Germany "may not reach the bottom (of the recession) this year," but could get to a point where the end was in sight. Merkel herself made no statement, and there was no communique.

BEHIND THE CLOUDS, RAYS OF HOPE?

¶13. (SBU) Germany's economic outlook is grim, as acknowledged by Holger Niermann, economic policy advisor to Chancellor Merkel. The day after Merkel's "Summit," four leading economic institutes predicted GDP would contract by 6 percent in 2009. A week later, the government followed suit, revising its own 2009 growth forecast to -6 percent (down from -2.25 percent). (Note: There was divergence on the 2010 outlook: while the government predicts 0.5 percent GDP growth, the institutes forecast -0.5 percent.) The main factor dragging the German economy down was exports -- down 23 percent in February 2009 from a year before -- dealing a crushing blow to the manufacturing sector. The economic institute IFO's manufacturing barometer is at the lowest level in 10 years.

¶14. (SBU) At the "Summit," however, some business and industry representatives were reportedly cautiously optimistic. There was a general consensus that the first quarter of 2009, with a 3.3 percent drop in output, represented the deepest phase of the recession. The economy would continue to contract during the remainder of 2009, but at a slower pace. Several forward-looking indicators -- an improved purchasing managers' index and business climate index -- has convinced some that the recession had an end in sight. The perception of a less uncertain future, whether justified or not, apparently reassured some "Summit" participants that a brighter future lay ahead.

READ MY LIPS: NO (OFFICIAL) NEW STIMULUS

¶15. (SBU) There was broad consensus at the April 22 "Summit"

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that time was not ripe for a third stimulus package, according to Niermann. (NOTE: Labor union representatives did reportedly appeal for more public spending, especially on infrastructure projects.) The feeling was that Germany's current stimulus packages, worth around 81 billion euros in 2009 and 2010, were already bearing fruit. In fact, the German measures were nearly as big as a percentage of GDP as the U.S. initiative, once "automatic stabilizers" were factored in, Niermann asserted. (NOTE: Embassy and many private forecasters believe these figures significantly overstate the size of the real stimulus.) The German government also feels its room for maneuver to counter the economic crisis is limited. The government deficit could reach 89 billion euros in 2009 and may climb to 132 billion euros in 2010. At 6.1 percent of GDP, this is twice the Maastricht criteria of 3 percent.

¶16. (SBU) The legislative timetable also makes an official third stimulus package prior to the September 27 elections unlikely. The Bundestag takes its summer recess beginning July 4, only to reconvene after the elections (barring an extraordinary session). According to Dietrich Jahn, Deputy Director General, Ministry of Finance, the political timetable is equally inauspicious. Jahn told Econoff the German government had studied the 2008 "Bush stimulus," and concluded its effects lasted about three months. There were more than three months left until the September elections, he noted.

¶17. (SBU) Merkel's chief economic adviser, Jens Weidmann, told EMIN that the only substantive new stimulus measure before the elections would be the expansion of the car scrapping (&wrecking8) premium from 1.5 billion to 5 billion Euros, which the government approved in early April. In addition to the car scrapping premium, which Goldman Sachs believes could translate into the sale of two million more cars this year, other modest measures that can be enacted by executive order are in the works. One is the recent extension from 18 to 24 months of subsidies for firms agreeing to retain workers part-time -- the so-called

"short-shift" scheme. Merkel also recently floated the idea of new tax cuts)- basically raising the threshold for higher-level incomes)- to co-opt rival SPD tax cut schemes, and appease her CSU allies. This being Germany, however, a number of critics have attacked her proposals as being fiscally imprudent in light of soaring deficits. Poorer states also fear it could mean a reduction of federal subsidies.

IT'S ALL ABOUT JOBS

¶8. (U) Whatever positive signs some German businesses may see, there is no good news on the jobs front. The unemployment rate stands at 8.4 percent -- up from 7.8 percent in November 2008 -- and is rising. The number of jobless could grow by one million to 4.7 million by the end of 2010, according the Germany's leading economic institutes. The IFO employment barometer is at its lowest level since July 2003. Job losses in the construction, automotive and chemical sectors are expected to be particularly severe. This will likely depress consumption for some time; indeed, the most recent consumer data showed no signs of a turn-around.

¶9. (U) There is some concern that social stability could start to crack. Prior to the April 22 "Summit," the head of the German Trade Union Federation (DGB), Michael Sommer, warned that mass layoffs would be taken as a "declaration of war" by workers and unions. He added that a contraction of 6 percent was comparable to the economic situation in the early 1930s, which helped bring the Nazi regime to power. "You know how people react when they are losing their livelihood," Sommer said. Sommer for one would like to see a third economic stimulus package to safeguard jobs. SPD presidential candidate Gesine Schwan agreed, and warned that the ongoing economic crisis could unleash violent reactions

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from a desperate population. These comments, however, drew sharp rebukes from Chancellor Merkel, President Koehler, and business and economic commentators, who accused Sommer and Schwan of "scare-mongering."

¶10. (U) In fact, worker demonstrations have thus far been peaceful. About 3,000 workers -- among them 1,200 French factory workers -- gathered in Hannover on April 23 to protest plans by car parts supplier Continental to close factories in Germany and France, which would eliminate 1,900 jobs over the next 12 months, and no major labor upheaval is expected by most analysts. Even the annual May Day protests were less traumatic than some had predicted. Germany's comprehensive social system may be dampening the extent of the unrest.

COMMENT

¶11. (SBU) Despite a lack of deliverables, Merkel's April 22 "Economic Summit" reminded many German voters that the steadiest hand was already at the helm. While the Chancellor brandished her mastery of the most important campaign issue, the economy, her rival for Chancellor Frank-Walter Steinmeier, also present, appeared once again to be a bit player. Although the recession's end is not imminent, some German businesses are reportedly more confident and optimistic about the future. Rays of hope, however tenuous, may be supporting the Chancellor's argument that a third stimulus package is not needed, despite rumblings by the trade unions. The legislative timetable likewise makes it unlikely the Chancellor could get a package through the Bundestag before the September 27 elections even if she wanted. With a deteriorating employment outlook, however, pressure on Merkel to stimulate the economy ahead of the elections will grow, most likely leading to new pledges to

boost public spending, cut taxes, or both. In the meantime, smaller measures such as additional funding for "short-shift" work and the car scrapping premium may amount to an unofficial third stimulus -- this one by stealth.
Koenig